



DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Regulatory Commission of Alaska

Sean Parnell, Governor
Emil Notti, Commissioner
Robert M. Pickett, Chairman

December 1, 2009

In Reply: Finance
LO#: L0900604

Brad Reeve
General Manager
Kotzebue Electric Association, Inc.
P.O. Box 44
Kotzebue, AK 99752

Re: PC91-0509A Fuel Cost Revision for Kotzebue Electric Association, Inc.
PC78-1107E Fuel Cost Revision for the City of Buckland

Dear Mr. Reeve:

On November 10, 2009, the Regulatory Commission of Alaska (Commission) received fuel cost revisions designated as PC91-0509A and PC78-1107E for Kotzebue Electric Association, Inc. (KOTZEBUE) and the City of Buckland (BUCKLAND), respectively. Both filings propose to pass through utility fuel costs which, for Power Cost Equalization (PCE) purposes, include losses for various fuel swaps. The losses total \$2.115 million and appear to be allocated between the two utilities based on gallons of fuel purchased, which then flows through the cost of power adjustment calculations for which the utilities propose to receive PCE subsidies.

It is unclear whether these costs are allowable under the PCE program. When we recommend PCE levels to the Alaska Energy Authority (AEA) for PCE subsidy, the standard by which we are bound is set forth in statute. Applicable statutes establish PCE levels based on allowable revenue requirement costs for rate regulated utilities.¹

¹Specifically, AS 42.45.110(a) states in relevant part:

Costs used to calculate the amount of power cost equalization for electric utilities eligible under AS 42.45.100-45.45.150 include all allowable costs, except return on equity, used by the Regulatory Commission of Alaska to determine the revenue requirement for electric utilities subject to rate regulation under AS 42.05.

In addition, AS 42.45.110(g) states:

The Commission shall determine the cost of fuel for each eligible electric utility using the procedure for approving fuel cost rate adjustments of electric utilities subject to rate regulation under AS 42.05.

In trying to reconcile the use of fuel swaps and whether they apply to PCE subsidies, we are not convinced fuel swaps (particularly losses) would be approved in a revenue requirement. Given this uncertainty regarding the treatment of losses from fuel swaps in a revenue requirement proceeding, it is not clear whether costs for fuel swaps constitute a "fuel cost" for purposes of our duties under AS 42.45. Accordingly, we cannot approve the utilities proposal to include fuel swap losses as fuel cost components for PCE purposes without further justification.

The size of the loss from fuel cost swaps (totaling \$2.115 million for both utilities) also raised questions regarding the prudence of the transactions as it appears that KOTZEBUE and BUCKLAND risked virtually all of their fuel costs in the transactions. We are concerned that the Alaska Legislature, in directing us in our PCE duties, may not have had in mind hedging strategies (particularly unsuccessful ones) in subsidizing power costs in rural communities.

We require KOTZEBUE and BUCKLAND to file by December 11, 2009, justification demonstrating good cause for treating fuel cost swap losses as allowable costs eligible for PCE subsidy. In doing so KOTZEBUE and BUCKLAND should address the requirements of AS 42.45.110(a) and discuss whether such costs would be allowed in a revenue requirement for a rate regulated utility, and explain why the fuel cost swaps should be considered a "fuel cost" under AS 42.45.110(g). If good cause is not provided, we may disallow all or a portion of the proposed costs for PCE purposes.

Additionally, we require KOTZEBUE and BUCKLAND to provide a history of all of their fuel hedging transactions from January 2000 to the present for each year therein where hedging costs were included in requests for PCE subsidy. The history should delineate all hedging gains or losses for each given year. The following information should also be included for each year:

- The contract date, the settlement date, any other relevant dates.
- The identities of the parties involved.
- The financial terms of each hedge.
- The fuel price at the time of each hedge.

- A description for each hedging transaction detailing the extent of professional consulting expertise received, if any, and the names and titles of all consultants involved.
- The amount hedged and the amount of fuel purchased.

Through this Letter Order, we also request that Alaska Energy Authority (AEA) comment on whether costs of this nature should be subsidized through the PCE program. Because AEA is the agency that distributes the PCE payments, we would greatly value any comments it may have. We believe this issue is important to address now because as long as fuel costs remain high, hedging strategies in PCE costs may continue to surface. We request that AEA file its comments on this topic by no later than December 11, 2009.

If KOZEBUE and BUCKLAND or the AEA have any questions regarding the subject matter of this Letter Order, please contact Kevin AufDerHeide, Utility Financial Analyst, at (907) 263-2131.

BY DIRECTION OF THE COMMISSION

Sincerely,

REGULATORY COMMISSION OF ALASKA



Rich Gazaway
Advisory Section Manager

cc: Steven Haagenson, Executive Director, Alaska Energy Authority